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Wealth-destroying private property rights

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ABSTRACT

According to conventional wisdom, privatizing the commons will create wealth. Yet in cases found throughout the developing world, privatizing the commons has destroyed wealth. To explain this phenomenon, we develop a theory of wealth-destroying private property rights. Privatization's effect on social wealth depends on whether privatizing an asset confers net gains or imposes net losses on society. The decision to privatize, however, depends on whether privatizing an asset confers net gains or imposes net losses on property decision makers. When decision makers are residual claimants, these effects move in tandem; privatization occurs only if it creates social wealth. When decision makers are not residual claimants, these effects may diverge; privatization occurs if it benefits decision makers personally even if privatization destroys social wealth. We apply our theory to understand wealth-destroying land privatization in Kajiado, Kenya.

1. Introduction

Every political economist knows that private property rights create wealth. Private property internalizes externalities, incentivizes optimal resource use, and enables markets that coordinate value-adding economic activity through the price system (Hayek, 1945; Mises, 1949; Demsetz, 1967). Which raises a question: Why has privatizing the commons in some places not created wealth but destroyed it?

From Ghana to Afghanistan, Kenya to Madagascar, Rwanda to Uganda, Cambodia, and Peru, the creation of private land rights has led to questionable economic benefits at best and economic losses at worst (see, for instance, Attwood, 1990; Baxter and Hogg, 1990; Place and Hazell, 1993; Migot-Adholla, Place, & Oluoch-Kosura, 1994; Hunt, 2004; Bassett, Blanc-Pamard, & Boutrais, 2007; Jacoby and Minten, 2007; Kerekes and Williamson, 2010; Loehr, 2012; Murtazashvili and Murtazashvili, 2015). To explain this phenomenon, we develop a theory of wealth-destroying private property rights.

Our theory is simple: Privatization's effect on social wealth depends on whether privatizing an asset confers net gains or imposes net losses on society. The decision to privatize, however, depends on whether privatizing an asset confers net gains or imposes net losses on property decision makers. When decision makers are residual claimants, these effects move in tandem; privatization occurs only if it creates social wealth. When decision makers are not residual claimants, these effects may diverge; privatization occurs if it benefits decision makers personally even if privatization destroys social wealth.[1]

We apply this logic to understand land privatization among the Maasai of Kajiado, Kenya, for whom creating private property rights destroyed rather than created wealth. We find that wealth-destroying private land rights in Kajiado were created by property decision makers who were not residual claimants and whom land privatization benefited personally.

We develop our theory with an eye to analyzing the specific case of Kajiado, and varying particulars of other cases of state-led land privatization counsel care in extrapolating from the former to the latter. At the same time, the central reasoning our theory offers and the privatization situation that Kajiado presents are quite general. We therefore hope that others will find our framework useful for extension and application to other cases of wealth-destroying privatization in the developing world.

Our paper is most closely connected to the literature that examines the state's ability to improve economic outcomes by designing property regimes.[2] Traditionally, this literature considers the

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[1] On the importance of residual claimant status to the wealth-producing capacity of governance arrangements, see Leeson (2011) and Salter (2015).

[2] Our paper is also connected to the literature on self-governance, which considers privately created property regimes. Demsetz (1967), for example, studies the emergence of private property rights among forest-animal hunters in eighteenth-century Quebec. Anderson and Hill (1975, 2004) study the private emergence property rights in the American West. Benson (1989a) does so in the context of preliterate societies, and Benson (1989b) and Kerekes and Williamson (2012) do so in the context of medieval Europe. Leeson (2007a, 2007b, 2009) examines privately created property regimes among the Caribbean pirates, in precolonial Africa, and along the historical Anglo-Scottish border. Most recently, Skarbek (2014) considers the private creation of property rights in prison gangs.

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difficulties of improving economic outcomes through state-created common property (see, for instance, Mises, 1920, 1949; Hayek, 1945; Boettke, 1990, 1993, 2001; Kornai, 1992). A different strand, however, considers the difficulties of improving economic outcomes through state-created private property (see, for instance, Anderson and Hill, 1983, 1990; McChesney, 1990, 2003; Easterly, 2008; Murtazashvili and Murtazashvili, 2015, 2016a, 2016b).[3]

Empirically, this research finds that the conventionally predicted economic effects of state-led privatization do not manifest universally. Recent field work conducted by Murtazashvili and Murtazashvili (2015, 2016a, 2016b), for instance, suggests that state land-titling efforts in Afghanistan have not improved welfare. Theoretically, this research identifies the causes for such failure. Anderson and Hill (1983), for instance, demonstrate how costly rent-seeking may dissipate new wealth promised by state-led privatization, leaving society no richer than it was to start. Our analysis contributes to this literature by demonstrating how, even when rent-seeking is costless, state-led privatization may destroy existing wealth, leaving society poorer than it was to start.

2. A theory of wealth-destroying private property rights

Private property rights offer society potential benefits. Relative to common property, such rights tend to prevent resource overuse, provide stronger incentives for investment, and direct productive economic activity via market prices. In a pastoralist society, for example, private land rights may prevent overgrazing, promote investment in land improvements, and facilitate alternative uses for land, such agricultural cultivation, when they are more valuable. Additionally, legal titles that grant private land rights may provide stronger tenure security and protect against encroachment.

These benefits, however, are not free. Private property rights also impose costs on society. Relative to common property, such rights tend to require more resources to define and enforce (Anderson and Hill, 1975; Field, 1989; Lueck, 2002). In certain environments, private property rights are also more expensive to use. In a pastoralist society that inhabits an arid or semi-arid region, for example, it is often cheaper to realize scale economies when land is held in common than through costly market transactions under private property (Onchoke, 1986; Coleman and Mwangi, 2015; see also, Dahlman, 1980; Ellickson, 1993; Platteau, 2000). Similarly, in such a society, common land holdings may insure individuals against drought risk more cheaply than arranging insurance through markets when land is owned privately (Kabubo-Mariara, 2005; Coleman and Mwangi, 2015).

Like all choices, the choice between property regimes therefore involves tradeoffs. A property regime's effect on social wealth—the aggregate money value of all assets in a community—depends on how it negotiates these tradeoffs. When the social benefits of private property in some asset exceeds the social costs, creating private property rights in that asset creates social wealth. When the opposite is true, doing so destroys social wealth.

While the consequences for social wealth of privatizing an asset currently found in the commons depends on whether the asset's privatization confers net gains or imposes net losses on society, the decision to privatize the asset depends on whether its privatization confers net gains or imposes net losses on the people who have authority to make property decisions relating to it—the property decision makers (Riker and Sened, 1991). If privatizing the asset would increase property decision makers' personal wealth relative to leaving the asset in the commons, they will privatize it, and vice versa.

Crucially, privatization's effect on the personal wealth of property decision makers may but need not vary positively with privatization's effect on social wealth. The relationship between these effects depends on whether property decision makers are residual claimants. A residual claimant is a decision maker with a personal claim to net changes in the aggregate money value of an organization's assets—to changes in organizational wealth, positive or negative—reflecting changes in the productivity of the organization's assets minus the cost of producing productivity changes. In the context of societal decision makers, such as property decision makers, a residual claimant is thus a decision maker with a personal claim to net changes in the aggregate money value of a community's assets—to changes in social wealth, positive or negative—reflecting changes in the productivity of the community's assets minus the cost of producing those productivity changes.

When property decision makers are residual claimants, the effect that privatizing an asset has on their personal wealth moves in tandem with the effect it has on social wealth. To see this, consider a hypothetical society of pastoralists where land is held in common but other property, such as livestock, is owned privately, and where land decisions are made by a traditional council of elders whose members collect incomes from the productive activities of the pastoralists in their community. In this situation, the council members manage the community's land and in return receive a share of the community's aggregate income generated from the pastoralists' productive activities, which combine land with their other assets. Council members' personal wealth thus varies positively with social wealth; council members are residual claimants. This hypothetical scenario is similar to that in which the Maasai operated historically. In their communities, livestock was owned privately, land was held in common, and a "council of elders. . .manage[d] the affairs of the area as if they 'owned' the land" (Rutten, 1992: 271). Council members' personal wealth thus depended partly on how their land decisions affected the community's wealth.

Suppose that for a minority of the pastoralists in the community, the costs of private land rights would exceed the benefits. For example, overgrazing imposes a cost on them, but their cost of fencing parcels—the technology available for enforcing exclusive claims—is higher still. For the majority of pastoralists, however, the benefits of private land rights would exceed the costs. For instance, these pastoralists may be more productive, so the cost that overgrazing imposes on them is higher than for the others and higher than the cost of fencing parcels.

What will the property decision makers—here, council members—do? They will privatize land if the net benefit of private land rights for the latter pastoralists, privatization's beneficiaries, exceeds the net cost of private land rights for the former pastoralists, privatization's losers, and leave land in the commons if the reverse is true. In the former case, privatization would increase social wealth and thus increase the personal wealth of the council members. In the latter case, privatization would decrease social wealth and thus decrease the personal wealth of the council members.

Now consider the situation when property decision makers are not residual claimants. Suppose, for example, that state fiat transfers land decision authority to government officials in the country in which our society of pastoralists is located. Like most government officials, these officials do not have personal claims to tax revenues, and the potential indirect benefits of tax revenues that might accrue them personally, such as an expansion of the government's general budget, are negligible. Officials' personal wealth thus does not depend on social wealth; officials are not residual claimants.

[3] See also, Bromley (1989, 2009); Heller (1998); Herbst (2000); Platteau (2000); Arrunada (2012); Bromley and Anderson (2012). A related literature emphasizes the importance of distributional conflicts and power relations in generating or preserving "inefficient" property institutions. See, for instance, Libecap (1989), Knight (1992), and Platteau (1996).